IN THE

Supreme Court of the United States

OCTOBER TERM, ~~1966~~ 1967

No. ~~1301~~ 104

ALEXANDER TCHEREPNIN, MING TCHEREPNIN, CHARLES NOLL, MAYBELLE NOLL, HARRY BLOCK, JEANETTE A. BLOCK, WERNER D. BLOCK, ADRIAN DA PRATO, PETER DA PRATO, FREDERICK D. WAHL, ANNE W. WAHL, THEODORE MACHATKA, MARIE B. MACHATKA, JOSEPH NOVAK, FRANCES NOVAK, MARYBETH SIMJACK WALTER R. ANDERSON AND HELEN K. KELLOGG,

Petitioners,

vs.

JOSEPH E. KNIGHT, JUSTIN HULMAN, CITY SAVINGS ASSOCIATION, DENNIS KIRBY, HARRY HARTMAN, LOUIS KWASMAN, ROBERT FRANZ, STANLEY PASKO, JOSEPH TALARICO, JR., HERBERT J. HOOVER, ROBERT M. KRAMER, C. ORAN MENSIK AND GLORIA MENSIK SPRINCZ,

Respondents.

REPLY TO BRIEFS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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The two Briefs filed by respondents may not require a reply as to the issues before this Court on consideration of a Petition seeking Certiorari. No objections of any real substance are raised by them. But interwoven from cover to cover into arguments mostly irrelevant at this stage

are inaccuracies as to facts, statutes, and case law affecting the validity of every contention.

At this point it is impractical because of time and space factors to correct every departure from fact and law. A series of examples may suffice to place respondents' Briefs in proper perspective. Let us consider the following:

1. The Jenner Brief (p. 7, line 10) asserts:

> "As a matter of fact, petitioners, in oral argument below *abandoned* their contention that they are by virtue of the Securities and Exchange Act of 1934 entitled to a prior claim to the assets * * *." (Emphasis supplied.)

The transparency of that assertion is evident, for a summary dismissal would inevitably have ensued, had that been true. That any lawyer in a Securities Act case would abandon the sole ground for federal jurisdiction is incredible. The assertion, of course, is without substance.

2. The Jenner Brief (p. 3) charges that petitioners' Statement of the Case is "inaccurate and misleading in its reference to * * * 'shares' and 'capital shares,'" asserting that the Illinois Act uses "the term 'withdrawable capital accounts' *when* referring to these interests." (Emphasis added.) In support are cited 11 selected sections of the Illinois Savings and Loan Act[1], beginning with § 761; but § 761 supplies a terse rebuttal, for it identifies these interests as "shares and share accounts," viz.:

> "(a) The *capital* of an association may be represented by withdrawable capital accounts (*shares* and *share accounts*) * * *.
>
> "(b) All *shares* and capital accounts shall be personal property * * *." (Emphasis added.)

In the context of respondents' charge, the word "when" means "whenever". Thus, it is their claim that whenever

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1. Ill. Rev. Stat. c. 32, §§ 701-944 (1965). That Act is sometimes hereinafter referred to as "the Illinois Act". References to section numbers relate to sections of that Act.

the statute refers to such interests, "withdrawable capital accounts" is the only term used; and that the word "share" does not appear in the Act. That is simply untrue.

Almost 50 sections of that Act, not just 11, make specific reference to the interests now before this Court, by a variety of terms. "Share" appears 29 times[2], which is more often than the 24 times "withdrawable capital accounts" is used specifically. In addition, the Act uses "matured shares"[3] "shareholders"[4] "share interests"[5] "share accounts"[6] "withdrawable shares"[7] and "withdrawable share accounts".[8] In one context or another the word "share" is used 51 times to refer to this type of capital investment. If indirect references are added, "shares" is still the favorite expression of the legislature in that Act, in discussing such capital interests. Considering that the term "withdrawable capital" (as distinguished from "withdrawable capital account") is also used 42 times,[9] and "account", "Capital" and "capital accounts", on other occasions,[10] the total usage of terms other than "withdrawable capital accounts" exceeds 100, demonstrating the extent of respondents' oversight.

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2. §§ 704(a), 742(d)(2), 742(d)(5), 743, 761(a), 761(b), 774(a), 774(b), 775(b), 794(b), 814(b), 841.3, 853, 875(b).

3. §§ 773(b)(3), 773(b)(4).

4. §§ 875(b), 909(c).

5. § 875(b).

6. §§ 710(t), 741(1), 743, 761(a), 773(g), 778(c), 780(c).

7. §§ 728(a)(5), 741(1), 778(c).

8. §§ 742(d)(2), 780(b)(2), 780(b)(3).

9. §§ 706(b), 706(h), 707(a), 710(i), 710(j), 710(k), 721, 724(c), 729(b)(4), 729(b)(5), 742(a), 743, 762, 773(a), 773(c), 773(d), 773(f), 774(a), 778(d), 780(b)(3), 780(b)(4), 780(d), 792.1, 792.7, 801, 822(a)(2), 848(b), 850(b), 850(c), 853, 877(a), 877(b), 903(d), 908.

10. 710(b), 726(f), 748(a), 768(a), 775(b), 780(b), 853, 748(a), 780(a), 780(b), 814(e), 710(s), 710(t), 743, 761(b), 768(a), 768(d), 773(b)(2), 774(b).

3. Respondents' aversion to the word "share" is understandable. "Transferable share" is one of the specific categories enumerated in the definition of "security" in the Securities Exchange Act of 1934[11] (hereinafter "the 1934 Act.").

Being confronted at the outset with the term "share" in both the 1934 Act's definition on which this case turns and throughout the Illinois Act, respondents attempt to escape this embarrassment by their suggestion, as above (Jenner Br. 3), that the word "share" does not even appear in the Illinois Act. But in using "withdrawable capital accounts" instead of "shares" 34 times (15 times at pages 2 and 3 alone) the draftsman is apparently forgetful that "shares and share accounts" is read into the text by reference each time, by mandate of Sec. 761 of that Act.

4. Next, at least 21 times that Brief substitutes for "share" and "shareholder", the terms "deposit", "depositor", "deposited" or "savings account", none of these being found in the Illinois Act. The Clark Brief for certain respondents substitutes "savings accounts" and "depositors" 15 times in its six page Argument. Thus they posit their own vocabulary of terms more to their liking, carrying frames of reference opposite to that intended by the Illinois legislature.

5. The Jenner Brief uses the word "withdrawable" at least 40 times and the above cited non-statutory terms 21 times within its 16 pages to promote the concept that shares representing the capital of a savings and loan association are (1) not shares at all and not capital, but are something else, and (2) are like bank savings accounts and therefore are creditor-debtor deposits, withdrawable at will at any time, none of which is of course true. That Brief does not even attempt to rebut the specification of characteristics and attributes of savings and loan shares and interests

11. § 3(a)(10), 15 U. S. C. § 78c(a)(10).

(Pet. 4 and footnote #5) urged by petitioners as the essential ones which bring capital shares and interests within the precedents cited in the Petition. That such essential characteristics of shares of an Illinois Association are typical of such capital interests in Associations nationwide has been established by petitioners' exhaustive analysis of federal laws and of the laws of each of the fifty states and of the District of Columbia (See Pet. 5).

6. Instead, that Brief supplies its own list of characteristics in 11 numbered paragraphs (pp. 2-3), charging that petitioners' Statement of the case "fails to set forth the characteristics" of the interests involved here (p. 3). A long list if irrelevancies are claimed to be omitted. Even were the "facts" listed there entirely true which they are not, for reasons hereinafter noted, they have no significance.

7. Points 9 and 10 (p. 3) are to be found in petitioners' list (Pet. 5) from which no essential characteristic was omitted. Nos. 9 and 10 concern the rights to vote for directors and to receive dividends if and only if and when, declared by the directors. The right to receive dividends must of course be distinguished from the right to "interest" on bank savings account deposits, contrary to respondents' Briefs (Jenner 13, Clark 6) and contrary to the majority opinion below (App. 26).[12] The right to "interest" on bank savings accounts is fixed and absolute, while the right to receive dividends is not.

8. The Jenner Brief (pp. 2-3) purports to rely on the Illinois Act. The word "depositors" used in point 11 (p. 3) as well as "depositor", "deposit" and "deposited" repeated over and over throughout that Brief, as stated above, do not appear in the Illinois Act but have been borrowed by respondents from the banking industry. Although that Brief says (p. 13) that "the Illinois courts have not definitely adjudicated this relationship"—as to whether

12. App. refers to the Appendix to the Petition for Certiorari.

the owners of capital interests in Illinois associations are creditors of the associations, the Illinois Supreme Court in *Gorham* v. *Hodge,* 126 N. E. 2d 626, 631, 6 Ill. 2d 31, 41 (1958) has done exactly that, settling the Illinois law. The Court held that an Illinois savings and loan association cannot accept "deposits", for that would create a debtor-creditor relationship with investors which an Illinois association is barred from doing. Accordingly, the majority holding of the lower Court that these capital interests are loans (App. 26) and its repeated use of the terms "deposit" and "depositor" (App. 21) are erroneous, as are the recurring assertions by respondents that these shares constitute a debtor-creditor relationship (Jenner 13), are like a "bank deposit" (p. 10) and have the characteristics of debt (p. 12). "Deposit", "depositor", "deposited" and "savings account" are thus improper usages. The Clark Brief likewise argues "creditor-debtor relationship" by ignoring the law and gratuitously asserting that these interests are "more commonly known as savings accounts" (pp. 3, 4). At page 3 it states that the lower Court followed the "notion" that the 1934 Act does not apply.

9. In the paragraph where the Jenner Brief argues (p. 13) that these interests are loans at interest and that the Illinois courts have not definitely adjudicated the relationship (ignoring *Gorham* v. *Hodge*), after citing an 1898 Indiana case it is stated that "numerous other" jurisdictions have held that it is a debtor-creditor relationship. It then cites two cases from the State of Washington (1934 and 1936), one from Pennsylvania, and no others. "Numerous other" jurisdictions have not so held, and any of those elsewhere are related to special situations, making them inapposite here.

Further, consistency not being one of its virtues, the Brief in the footnote at page 6 argues that the *Wisconsin Banker's* case held that shares in a federal association were

"investments" and not equivalent to bank deposits. Then after citing (p. 13) non-Illinois cases as controlling in Illinois, it argues that in the instant case the relationship is *not* one of "investment" (p. 14). Even more strange are the qualifying words used at page 6 to indicate that the Court in *Wisconsin Bankers* held that the shares were "not exactly" equivalent to bank deposits. In truth, the Court there held that they are very different. Similarly, at page 13, the brief says the Illinois courts have not "definitely" adjudicated the question of debtor-creditor as to such associations, while in truth, the Illinois Supreme Court *has* "definitely" adjudicated the matter in *Gorham* v. *Hodge*, as cited by petitioners in their Brief in the lower Court.

Further the statement in the footnote at page 5 that the court in the *American International* case drew a distinction between operating as a "savings and loan association" and "as a corporation" is not borne out by the decision. Operating "as a corporation" is required of such associations in many states including Illinois, and is a sensible way to operate even where not required.

10. Still endeavoring to establish debtor-creditor status for the interests here, which is the thrust of both Briefs, the Jenner Brief, point 5 (p. 3) sets out the always fully withdrawable argument, in keeping with the majority opinion below asserting that such interests are "fully withdrawable when issued". (App. 24.)[13] The Jenner Brief also argues that the right to withdraw at any time is equivalent to a right to rescind, without a law suit (p. 6). But in fact, the right to withdraw is a qualified one. The laws of virtually all fifty states, the District of Columbia, and of the

13. In making this argument, respondents ignore the fact that the amended complaint charges that petitioners' shares were *not* withdrawable at will (an allegation not disputed in the pleading by them). Further, respondents' debtor-creditor argument is irrelevant as pointed out in the S. E. C.'s *Amicus Curiae* Brief, pp. 10, 11, 14.

federal government permit, and in some states require, the directors of such associations to unilaterally impose restrictions on withdrawals if adequate funds are not available to meet all mortgage commitments and other cash requirements. As occurred with City Savings from 1957 to 1964, such restrictions can continue for years.

This is entirely unlike the situation of banks. If a bank cannot meet withdrawal demands of its depositor-creditors, subject to short notice requirements in such situations, the bank is considered insolvent and is closed, reorganized or taken over by another bank. Federal insurance is paid promptly.

That is not so as to savings and loan associations. If they go on a restricted payout basis, they are not considered insolvent unless the value of their assets shrinks below the total of creditors claims plus the total of so-called "withdrawable" capital. No federal insurance is payable until after a default occurs, meaning "insolvency".

11. The fact that a 1959 Illinois statute[14] (repealed in 1965) prohibited restrictions on withdrawability of new accounts accepted while an Association was on a restricted payout basis as to prior shareholders does not change the actual facts as they happened in this case: Such capital shareholders were simply unable to withdraw their investments in City Savings, on demand, because the Association was continuously in trouble financially due to inadequate cash throughout the years 1957 to 1964, and during that period it imposed restrictions on withdrawals as to all shareholders, new and old.

12. The confusion resulting from respondents' argument below that petitioners' capital interests were actually withdrawable at will at any time under that 1959 amendment, is manifest. The Court below was led into so holding (App. 21, 24, 26). Aside from the factual inability of in-

14. Ill Rev. Stat. C. 32, Sec. 773(h) (1963).

vestors to withdraw at will from City Savings or any association which remains open but unable or unwilling to pay on demand, the 1959 Illinois amendment was as unconstitutional as the 1953 amendment held invalid in *Gorham v. Hodge.* The acceptance of capital accounts, particularly under respondents' interpretation, would have created a "demand account". This would have engaged such associations in the banking business, an activity prohibited to them by Article XI, Sec. 5 of the Illinois Constitution. This prohibition is reflected in Sec. 709(a) of the Illinois Act which provides, "No association to which this Act shall apply shall accept or carry any demand * * * account."

13. The effort of respondents to transmute the status of these investors stands in isolation, against a background of laws similar to those in Illinois in almost all jurisdictions. Such laws provide no comfort to respondents. The legislatures in all states and the Congress have carefully constructed a form of business enterprise where the debtor-creditor relationship would not exist between an association and the investors in its capital. Such capital investments generally are designedly called "shares", "capital accounts", and by other terms of recognized meaning which cannot be confused with banking usage.

To understand the reason for this structuring of the entire industry, it is necessary to compare the long-term mortgage lending function of savings and loan associations with the commercial banking functions of banks, historically and at present. Because banks are subject to demand withdrawals by depositors, and have a debtor-creditor relationship with them, by necessity they have avoided freezing any substantial part of their deposits into long-term real estate mortgage loans. On December 31, 1965, of the total of almost $378.9 billion of assets of commercial banks in the United States, only 13.1% was invested in such loans.[15]

15. Rep. of Call 74, Dec. 31, 1965, FDIC, Washington, D. C. p. 2.

Savings and loan associations on the other hand were created and have multiplied to fill the gap thus left in the national economy. They accumulate capital by selling their shares across the country, and gather together the invested monies of their shareholders for the express purpose of providing funds to satisfy the need for long-term real estate mortgage loans, in their own jurisdictions and in other states. The investments are designated as shares of capital, under one term or another, because that is characteristic of the relationship desired and created by the investment contract. In virtually every jurisdiction, the investment is subject to withdrawal from time to time, if, and only if, the associations have funds available in excess of their currently owing cash commitments for the purpose for which they were founded. On December 31, 1965, of the total of almost $129.5 billion of assets of savings and loan associations in the United States, 85% was invested in such mortgages.[16]

14. The statement in the Jenner Brief (pp. 9, 10) that such interests are not traded either on exchanges or on over the counter markets, and the similar holding of the lower court (App. 28) ignore the holdings of *Fratt* v. *Robinson* (9 Cir. 1953), 203 F. 2d 627, 630, 631; *Kardon* v. *National Gypsum Co.* (D. C. E. D. Pa. 1946), 69 F. Supp. 512 (Pet. 9), that such trading is unnecessary. In any event the Jenner statement is simply unsupportable. They are based on assumptions, contrary to general experience. It is not necessary that there be daily trading or frequent trades at all times for securities to be commonly traded. At page 10 that Brief refers to the historical context of the 1934 Act, citing the Great Depression. By 1933 a great many of the substantial associations in most of the large commercial centers of the country had restrictions

16. An. Rep. Dec. 31, 1965, Fed. Home Loan Bank Board, Washington, D. C., p. 133.

in force on withdrawals. Some associations failed and were liquidated; others continued for years on a restricted withdrawal basis. Those investors who required the use of their funds invested in so-called "withdrawable" but actually nonwithdrawable capital shares sold their investments as best they could. Naturally, the amounts realized from such trading fluctuated widely, depending in part upon the reputation of management, its skill in the original investment of funds and the activities of price manipulators. A reputation for loose lending policies would not enhance the market price of shares.

15. The Clark Brief (p. 6) asserts blandly that such interests are *not* transferable. That the Illinois Act (§ 768 (b)) expressly provides that such interests may be transferred by the holder, did not deter respondents in their Briefs in the lower Court, and respondent Clark here, from stating the contrary. Such interests are transferable in all jurisdictions, even where the statutes make no specific provision. An innate attribute of property is the right of the owner to dispose of it, unless restricted by the terms of the grant to him, by law or by contract.
to him, by law or by contract.

16. That the interests presently before this Court are traded over the counter is apparent from the plight of the 14,000 investors in City Savings Association. Some of those in serious financial straits or having other motives do sell their shares, as is evident to anyone with whom shareholders communicate in this matter. The same was necessarily true even before the association was in liquidation during the seven year priod of restrictions on withdrawals. This kind of selling is nothing new, for in 1934 the Securities and Exchange Commission granted a temporary exemption from the 1934 Act as to such interests traded on the Cleveland Stock Exchanges. (S. E. C. Release No. 26.) Industry leaders report that there was heavy trading in such interests in large commercial centers.

17. The Jenner Brief at page 4 asserts, as to the majority opinion below, that:

> "The Court carefully limited its opinion to the facts of this case," and "to the characteristics of City Savings Association's 'withdrawable capital accounts' as they related to the statutory definition of the term 'security' ".

This is raised in rebuttal to petitioners' assertion that the majority opinion below rejected consideration of all categories of the definition of "security" in the 1934 Act (App. 23) other than "an instrument commonly known as a security;" (App. 24) and that this holding of the Court below necessarily would apply in all cases of interpretation of that definition, involving any security.

The Court did not, by direct caveat or otherwise, "carefully limit its opinion to the facts of this case," as is sometimes done. On the contrary, it speaks of the "*type of interest* now before us," (App. 24) thus making its opinion applicable to associations everywhere in this nation. Further, "type of interest" could and probably would be construed to cover every investment interest having some or all of the characteristics which the Court held are not within the ordinary concept of a security, and which are referred to by the Court in other paragraphs of its opinion. (App. 24-25.) That opinion and respondents say in unison that withdrawable savings and loan capital shares have characteristics unlike those in the "ordinary concept of a security", again making that concept controlling.

18. In addition, the Court's attention is directed to *Archer et al,* v. *S. E. C.*, 133 F. 2d 795 (8 Cir. 1943), involving certain certificates issued by Pacific States Savings and Loan Association. Those certificates represented

interests in withdrawable capital.[17] At page 801 the decision discloses that these certificates were involved in misconduct by brokers in violation of § 15(c)(1) of the 1934 Act and a rule promulgated pursuant thereto. The decision indicates that the certificates were traded over the counter, that the price fluctuated widely, was manipulated, and that the improprieties constituted a violation of a section of the 1934 Act involving a "security". Further, in the face of the above, it is clear that the decision below puts the 7th Circuit in conflict with the 8th Circuit and its decision in *Archer,* a ground for certiorari which was not known to these petitioners until the *Archer* case was called to their attention on May 25, 1967.

17. The decision does not set forth this fact; but on May 29, 1967, counsel for petitioners ascertained from the Department of Investments, Division of Savings and Loans of the State of California, at San Francisco, California (Messrs. R. McAllister and John Ruster) that the certificates of Pacific States Savings and Loan Association were of the withdrawable capital type and not guaranty or permanent reserve shares.

CONCLUSION.

The respondents have seized the opportunity granted them to answer the Petition for Writ of Certiorari and have employed it to present a full-scale brief on the merits. It is not the office of such a petition to present the petitioner's full case on the merits. Nor is it the office of an answer to present respondents' full case on the merits as their argument for denial of the petition. Upon analysis there is no point which the respondents have made in either of the briefs which is now valid. They have provided the Court with a preview of the many fallacies upon which their arguments directed to the merits are based.

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